

No. 10245.

IN THE  
**United States Circuit Court of Appeals**  
FOR THE NINTH CIRCUIT

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CHARLES CHAPLIN,

*Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

---

COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

*vs.*

CHARLES CHAPLIN,

*Respondent.*

---

**BRIEF FOR PETITIONER,  
CHARLES CHAPLIN.**

UPON PETITIONS TO REVIEW A DECISION OF THE TAX  
COURT OF THE UNITED STATES.

---

LOYD WRIGHT,

CHARLES E. MILLIKAN,

HERSCHEL B. GREEN,

111 West Seventh Street, Los Angeles,  
*Attorneys for Petitioner, Charles Chaplin.*



## TOPICAL INDEX.

	PAGE
Statement of the case.....	2
Specification of errors.....	15
Summary of argument.....	17
Argument .....	18
(a) Said stock was issued to petitioner June 9, 1919, and ever since he has exercised all incidents of ownership thereof, including voting said stock and all thereof at all of the meetings of the corporation held since said date .....	20
(b) Dividends were declared on said 1000 shares of stock while held by the depositary and placed in trust for petitioner's benefit .....	26
(c) The corporation at all times considered and treated peti- tioner as the owner of said stock after its issuance on June 9, 1919, in all corporate affairs.....	29
(d) The consideration for the issuance of said 1000 shares of stock was the execution by petitioner of the dis- tribution agreement of February 5, 1919.....	34
(e) Said 1000 shares of stock were placed with a depositary as security for the performance by petitioner of a dis- tribution agreement entered into between United Artists Corporation and petitioner on February 5, 1919.....	41
(f) The dividends declared on said shares of stock while in the possession of the depositary were impounded to en- courage compliance by each artist with his distribution contract .....	48
(g) The terms of petitioner's contract so far as the same related to the number of photoplays required to be de- livered and the time of delivery were abandoned both by United Artists Corporation and by petitioner.....	49
Conclusion .....	54

## TABLE OF AUTHORITIES CITED.

CASES.	PAGE
A. R. Jones Oil, etc. Co. v. Commissioner, 114 Fed. (2d) 642....	19
Ambassador Petroleum Company v. Commissioner, 28 B. T. A. 868 .....	39
Bassett v. Commissioner, 33 B. T. A. 182.....	28
Bogardus v. Commissioner, 302 U. S. 34.....	19
Borg v. International Silver Co., 11 Fed. (2d) 147.....	26
Bynum v. Commissioner, 113 Fed. (2d) 1.....	19
Carhahan, H. L., v. Commissioner, 21 B. T. A. 893.....	46
Commissioner v. Boeing, 106 Fed. (2d) 305; cert. den. 308 U. S. 619.....	19
Commissioner v. Southern Bell T. & T. Co., 102 Fed. (2d) 397 .....	19
Farish v. Commissioner, 103 Fed. (2d) 63.....	19
Federal Development Co. v. Commissioner, 18 B. T. A. 971....	28, 45
Hawke v. Commissioner, 109 Fed. (2d) 946.....	19
Hegarty v. American Com. Power Corp., Dela. Chancery Rep., Vol. 20, p. 231.....	25
Helvering v. Tex. Penn Oil Co., 300 U. S. 481.....	19
Hopkins, William R., v. Commissioner, 41 B. T. A. ....	27
Lee v. Reifler & Sons, 43 Fed. (2d) 364.....	52
Semar v. Commissioner, 27 B. T. A. 989.....	22
Snyder v. Duffy, 43 Fed. (2d) 642.....	23, 25
Union Trust Co. of Butler v. Commissioner, 84 Fed. (2d) 386	19
STATUTES.	
Delaware Corporation Law, Sec. 3.....	40
Internal Revenue Code, Sec. 272(a) (1).....	1
Internal Revenue Code, Sec. 1101.....	1
Internal Revenue Code, Sec. 1141 .....	2, 18
Internal Revenue Code, Sec. 1142.....	2
TEXTBOOKS.	
6a California Jurisprudence, pp. 357, 247.....	52
18 Corpus Juris Secundum, Sec. 475, Subpara. A.....	25

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BRIEF FOR PETITIONER,  
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Petitioner instituted proceedings before the Tax Court pursuant to Internal Revenue Code, Sections 272 (a) (1) and 1101, for the redetermination of a deficiency in his income tax asserted by the respondent for the calendar year 1935. His petition alleged errors which were denied in the respondent's answer thereto. The Tax Court's decision holding that there was a deficiency in income tax for the year 1935 was promulgated on the 24th day of February, 1942, and entered on the 6th day of April, 1942.

These proceedings are brought to this court by petition for review filed with the Clerk of said Tax Court on June 8, 1942 [R. 47-54], pursuant to the provisions of Internal Revenue Code sections 1141 and 1142. A copy of said petition for review, with notice of the filing thereof, was served upon the respondent on June 8, 1942. [R. 56.]

### Statement of the Case.

On February 5, 1919, petitioner, Douglas Fairbanks, and Mary Pickford, artists, and David W. Griffith, producer, entered into an agreement to associate themselves together in the distribution of motion pictures thereafter produced by them. [Exhibit 1, R. 73.] All of the parties were favorably known in all parts of the world where motion pictures were exploited and exhibited and their respective names had exceptional trade value. [R. 74.] The agreement provided, among other things, that they would organize a corporation to be known as the United Artists Corporation (hereinafter sometimes referred to as the corporation), with two classes of stock, class A—6000 shares of 8 per cent cumulative preferred stock, par value \$100 per share, and class B—9000 shares of common stock, no par value. Each of the parties was to purchase 1,000 shares of the preferred stock at \$100 per share, it being contemplated that this stock would be redeemed by the corporation. [R. 75-76-78.] The common stock was to be issued and paid for in the following manner [R. 76]:

“One thousand (1000) shares to each of the above named persons in part consideration of the execution and fulfillment of the contract pertaining to the exploiting, marketing, distributing and turning to account of his or her motion pictures with the said cor-

poration. The details concerning the delivery of the aforesaid common shares of stock to each of the aforesaid persons shall be more fully set forth in the agreement between said person and said corporation pertaining to the exploiting, marketing, distributing and turning to account the motion pictures produced by such person and included in such contract.

One thousand (1000) shares to William G. McAdoo who is to become the General Counsel of said corporation.”

All of the common stock was to be issued “subject to the right of the corporation for its then existing stockholders to repurchase the same in the event of such stockholder desiring to sell any portion or all of his or her shares of common stock in said corporation to any person who is not actively associated with such stockholder in the business of producing photoplays.” [R. 77.] The substance of this provision was included in the by-laws subsequently adopted by the corporation. [Exhibit 3, R. 105-6.]

On April 17, 1919, the certificate of incorporation of United Artists Corporation was filed with the Secretary of State of Delaware. [R. 67.] It authorized the issuance of 5000 shares of preferred stock, \$100 par value, and 9000 shares of common stock. The preferred stock was to have no voting rights. Each holder of shares of common stock was entitled to as many votes at all elections of directors as his number of shares multiplied by the number of directors to be elected. [Exhibit 2, R. 85.]

On February 5, 1919, petitioner signed a proposed distribution agreement which was subsequently executed by the corporation on June 13, 1919. [Exhibit 5, R. 114.]



Similar agreements were signed by Douglas Fairbanks, Mary Pickford and D. W. Griffith. The agreement signed by petitioner provided, among other things, that he would produce and deliver to the corporation nine photoplays of between 1600 and 3000 feet in length within three years from the date thereof. [R. 117.] The corporation obligated itself to give petitioner's name "chief prominence" in the advertisements of his pictures [R. 120], to use its best efforts to market the films upon a basis of sharing in gross receipts, and agreed that no franchise or territorial right for the use of such photoplays should be made without his written consent. [R. 123.] Subdivision (i) of the "Third" paragraph of this agreement reads as follows:

"(i) And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation nine (9) photoplays. Should said artist be unable to deliver nine (9) such photoplays because of illness or incapacity during the said entire period of three (3) years, said artist shall receive so many of the aforesaid one thousand (1000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation." [R. 124-125.]



At a special meeting of the board of directors of United Artists Corporation held on May 29, 1919, the following resolutions were adopted:

“Whereas in the judgment of the Board of Directors the photoplays agreed to be delivered to this Corporation under said contracts are necessary for the business of this Corporation and constitute good and sufficient consideration for the issue of five thousand (5000) shares of the common stock of this Corporation, the same being without par or nominal value:

Resolved, that in consideration of the delivery of said contracts to this Corporation the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq., one thousand (1000) shares of no par value of this corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

Resolved that in consideration of the delivery of said contracts of this Corporation, the proper officers of this Corporation be, and they hereby are authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1000) shares of no par value each, making a total of four thousand (4000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known

as Mary Pickford) and this Corporation, and to no other person, said four thousand (4000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agreement for the holding and delivery of said four thousand (4000) shares of non-par value in accordance with the terms and provisions of said contracts between Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated February 5th, 1919, said escrow agreement to provide that while said four thousand (4000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of the same by its officers." [Exhibit 18, R. 231-4.]

On June 9, 1919, the corporation issued 9 certificates of stock—8 for 111 shares each and one for 112 shares—in which petitioner was shown as the owner. [R. 67.] The certificates were not delivered to petitioner, but were kept in the possession of the corporation until subsequently delivered to and deposited with the escrow agent in accordance with the agreement between petitioner and his associates and with the corporation.

The following entry appears in the journal of United Artists Corporation:

“June 9 (1919) Artists’ Con-  
tracts .....A-4 \$25,000.00  
Consideration for contracts  
with the four artists for delivery  
of photoplays to Corporation as  
per resolution of Board of Di-  
rectors adopted May 29, 1919  
(ratified by stockholders Sept.  
9, 1919)  
Capital Stock—common .....C-7 \$25,000  
Issued 5000 shares at no par  
value, but regarded to have a  
value of \$5.00 per share  
(verbal advice of General  
Counsel)” [Exhibit 14, R.  
205.]

On July 5, 1919, the petitioner, Douglas Fairbanks, Mary Pickford and D. W. Griffith entered into an agreement with the United Artists Corporation amending subdivision (i) of paragraph 3 of their respective agreements of February 5, 1919, as follows:

“And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be issued in the name of the said Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and one of which shall be for one hundred and twelve (112) shares, said certificates to be

delivered in escrow to a person or corporation to be agreed upon by the parties hereto. Upon delivery by the said Artist to the said corporation of each one (1) of the first eight (8) photoplays called for by this contract, such escrow agent shall deliver to the said Artist one (1) of said certificates for one hundred and eleven (111) shares, and upon delivery by the said Artist to the said corporation of the ninth (9th) photoplay called for hereunder, such escrow agent shall deliver to the said Artist said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation." [Exhibit 6, R. 140-1.]

On August 5, 1919, the petitioner, the United Artists Corporation, and one Dennis F. O'Brien, as escrow agent, entered into an agreement providing *inter alia* as follows:

"First: The Corporation shall forthwith deliver to, and deposit with, the Depositary the nine (9) stock certificates, representing in the aggregate one thousand (1000) shares of the common stock of the Corporation, which have been issued in the name of the Artist as aforesaid.

Second: Upon receipt of said stock certificates, the Depositary shall issue in respect thereof in the name of the Artist a certificate of deposit \* \* \*

Third: Upon delivery by the Artist to the Corporation of each one (1) of the first eight (8) photoplays called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to one (1) of said certificates

for one hundred and eleven (111) shares, whereupon the Depositary shall deliver one (1) of the same to the Artist upon surrender by the latter of the certificate of deposit herein provided for and shall issue to the Artist a new certificate of deposit, substantially in the form of that annexed hereto, in respect of the number of shares remaining in escrow. Upon delivery by the Artist to the Corporation of the ninth (9th) photoplay called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to said certificate for one hundred and twelve (112) shares, whereupon the Depositary shall deliver the same to the Artist upon surrender by the latter of the certificate of deposit which he then holds. At the expiration of said period of three years, the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow and are not the property of the Artist, and the Artist shall return to the Depositary the certificate of deposit which he then holds.

Fourth: Any and all dividends which may be declared upon the shares of stock represented by the Certificates deposited hereunder while the same, or any part thereof, are held in escrow by the Depositary shall be deposited by the Corporation in the Central Union Trust Company, No. 80 Broadway, New York City, in an account to be known as 'United Artists Corporation, Trust Account No. 1.' Upon delivery to the Artist by the Depositary, in the manner hereinbefore provided for, of each of the certificates deposited hereunder, the Corporation shall pay to the Artist one-ninth ( $1/9$ ) of all dividends which at the time of such delivery shall have been deposited in said account, together with accrued interest thereon. At the expiration of said period of three years, so much of

such dividends and interest thereon as remain in said account and are not due the Artist shall become the property of the Corporation.

Fifth: The Depositary shall not have the right to vote the shares of stock deposited hereunder.

\* \* \* \* \*

Seventh: This agreement shall be binding upon the heirs, legal representatives, successors and assigns of the parties hereto." [Exhibit 7, R. 143-7.]

The form of the certificate of deposit was as follows:

"Certificate of Deposit

No.	No. of Shares
Certificate of Deposit	
representing the Common Stock of United Artists Corporation.	

This Is to Certify that there have been deposited with Dennis F. O'Brien (herein called the 'Depositary'), under a written agreement, dated....., 1919, (a copy of which is on file at the office of Depositary), for the benefit of Charles Chaplin (herein called the 'Beneficiary'), nine (9) stock certificates representing in the aggregate one thousand (1000) shares of common stock of United Artists Corporation, without par value, and that under said agreement the Beneficiary will be entitled to a delivery of said stock certificates or some portion thereof upon surrender hereof and upon receipt by the Depositary of a written notice from United Artists Corporation that the Beneficiary is entitled thereto under the terms of said agreement.

The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation." [Exhibit 12, R. 194.]



Petitioner did not deliver any motion pictures to the corporation during the three-year period contemplated in the agreement of February 5, 1919 [R. 209, 216], nor was any modification of the agreement made during the three-year period extending the time in which the nine motion pictures should be delivered. [R. 217.] Upon the expiration of the three-year period none of the 1000 shares of stock held in escrow under the contract with petitioner was delivered back to the corporation [R. 217], nor was any demand made upon the escrow agent by the corporation, or any of its officers, directors, or stockholders that such shares of stock be returned to the corporation. [R. 217.] At the end of the three-year period none of the parties to the agreements had delivered all of the nine pictures required by their contracts to the corporation; but the depositary did not turn back to the corporation any of the stock standing in their names and held by him in escrow. [R. 217.]

In 1923 petitioner delivered to the corporation one photoplay, "Woman of Paris," which was released November 4 of that year. At that time the escrow agent turned over to him one certificate for 111 shares of stock. This left eight pictures undelivered by petitioner under his contract and eight certificates of stock still held by the escrow agent. [R. 196-198.]

On November 22, 1924, the petitioner, Mary Pickford, Douglas Fairbanks, Joseph Schenck and United Artists Corporation entered into an agreement further modifying the distribution agreement of February 5, 1919. [Exhibit 8, R. 148.] As modified, it recites that "Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all of the preferred and common stock of the corporation, now issued and outstanding" except certain qualifying shares,



and provides, among other things, that in addition to the nine pictures originally contracted for, Pickford will produce six feature photoplays and Fairbanks will produce five, all to be delivered by November 1, 1928; but neither "shall receive any additional common stock" beyond the amounts provided to be delivered to them during the term of their original contract. The agreement also provides that petitioner will produce five pictures to be delivered one each year, all to be delivered on or before January 1, 1929, instead of the eight undelivered pictures provided for in the original contract, and "The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin, shall be delivered to him in the proportion of one-fifth ( $1/5$ ) thereof upon the delivery of each motion picture photoplay by Chaplin to the corporation."

Thereafter petitioner produced and delivered to United Artists Corporation three pictures which were released on the following dates: "The Gold Rush"—August 16, 1925; "The Circus"—January 7, 1928; and "City Lights"—March 1, 1931. [Exhibit 15, R. 211.]

On October 31, 1928, petitioner delivered to the corporation the certificate for 111 shares of its common stock which had been released from escrow upon the delivery of the photoplay, "Woman of Paris," and at said time the 889 shares still held in escrow by Dennis F. O'Brien were delivered to the corporation. All of the certificates of stock were forthwith cancelled, and on the same date the corporation issued in the name of petitioner the following certificates of common stock: No. 83 for 166 shares; No. 84 for 167 shares; No. 85 for 166 shares; No. 86 for 167 shares; No. 87 for 167 shares; and No. 88 for 167 shares, a total of 1000 shares. [R. 197.] All of the foregoing

certificates were placed in escrow with Dennis F. O'Brien pursuant to the agreement dated February 5, 1919, as amended. Thereafter on November 8, 1928, there were released from escrow and delivered to petitioner certificates No. 83 for 166 shares; No. 84 for 167 shares, and No. 85 for 166 shares of the common stock of the corporation.

On February 27, 1931, certificate No. 86 for 167 shares was released from escrow and delivered to petitioner upon completion of the picture "City Lights."

All of the pictures delivered by petitioner to the corporation were much longer than the 1600 to 3000 feet specified in the agreement. [R. 316.]

On September 20, 1935, an agreement was entered into between petitioner and the corporation under which certificates Nos. 87 and 88 for 167 shares each were released to petitioner, together with accumulated dividends thereon in the sum of \$44,532.22, which had been paid to the escrow agent in the following years:

1930	\$ 6,680.00
1931	3,340.00
1932	3,340.00
1934	31,172.22

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Total	\$44,532.22
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[Exhibit 10, R. 169.]

No pictures were ever delivered by petitioner which would entitle him to the release from escrow of certificates Nos. 87 and 88 for 167 shares each.

The dividends had been deposited in a special bank account and interest on such deposits in the amount of

\$995 was paid to the petitioner when the stock and dividends were released. [R. 212, 306.] This amount was included in gross income in petitioner's income tax return for 1935.

The 1000 shares of common stock issued to William Gibbs McAdoo were surrendered to the corporation in 1920. Subsequently in 1924, 1000 shares were issued to Joseph M. Schenck. The stock referred to in this paragraph was never put in escrow.

When the original 9 certificates totaling 1000 shares of stock were put in escrow, petitioner did not sign them. [R. 191.] When these certificates were cancelled by the corporation and 6 certificates totalling 1000 shares were issued in their stead and placed in escrow, petitioner signed these 6 certificates in blank. [Exhibit 9, R. 166.]

After the organization of the corporation, petitioner attended stockholders' meetings, voted at such meetings for directors and otherwise, received notices, and signed proxies the same as any stockholder. [R. 220-1.] He was carried on the books of the corporation as the owner of 1000 shares of common stock. [R. 201, 252, 260-261.] Petitioner in many instances was referred to in the minutes of the corporation as the "owner of 1000 shares." [Exhibits 43, R. 265; 44, R. 267; 45, R. 269; 48, R. 272; 49, R. 275; 50, R. 250; 51, R. 279; 52, R. 281.] The dividends upon the stock standing in his name were deposited in a trust account in a New York bank in accordance with the escrow agreement. [R. 212.]

In computing the deficiency here in issue the respondent determined the fair market value of the 334 shares of common stock of the United Artists Corporation, delivered to petitioner from escrow in 1935, to be \$104,709

and added this amount to petitioner's income for that year.

In his income tax returns for 1935 petitioner treated the \$44,532.22 as dividends received in that year and not subject to the normal tax. The respondent determined that the \$44,532.22 did not represent "dividends" received in the taxable year and the amount was treated as ordinary income in determining the deficiency in tax. Petitioner filed with the respondent a claim for refund of \$24,938.04 representing the tax paid on the \$44,532.22 dividends.

In said claim petitioner contended that the tax should have been paid on said dividends in the year in which the same were received and not when released from escrow some years later.

### **Specification of Errors.**

Petitioner relies on all of the points contained in his statement heretofore filed [R. 51-53, 342, 343], to wit:

The Tax Court erred:

1. In holding that there is a deficiency of \$63,427.19 in petitioner's income tax for the year 1935.
2. In holding that petitioner became the owner of 334 shares of common stock of United Artists Corporation in 1935 when said stock was released from escrow and delivered to petitioner.
3. In failing to hold that petitioner became the owner of the 334 shares of common stock when issued to petitioner in 1919.
4. In failing to hold that said one thousand shares of common stock issued to petitioner in 1919 constituted a consideration for the execution by the petitioner of the distribution agreement.

5. In failing to hold that the shares of common stock were held by the escrow agent as security for the performance by petitioner of his contract to deliver pictures.

6. In failing to hold that it was the intention of all parties to the original contract that petitioner should become the owner of said shares of common stock when issued in 1919.

7. In failing to hold that the dividends declared and paid on said common stock when held in escrow constituted income to petitioner in the years in which said dividends were paid.

8. In holding that said dividends constituted taxable income to petitioner in 1935.

9. In holding that the fair market value of the 334 shares of common stock, namely, \$104,709.00, constituted taxable income to petitioner in 1935.

10. In holding that petitioner derived income from the release from escrow and delivery to petitioner of the 334 shares of common stock in 1935.

11. In that its decision was not supported by the evidence and is contrary to law.

12. In rendering decision for the respondent and against petitioner.

### Summary of Argument.

In support of his appeal, petitioner respectfully submits that the evidence shows without contradiction that petitioner became the owner of 1000 shares of common stock of United Artists Corporation on June 9, 1919, and thereafter continued without interruption as the owner of said 1000 shares of said stock. The 334 shares of said stock in connection with which the tax involved in this proceeding has been assessed were a part of said original issue of 1000 shares.

Our argument in support of the proposition above stated will be subdivided, and appropriate references to the record will be made under each subdivision. These subdivisions are as follows:

(a) Said stock was issued to petitioner June 9, 1919, and ever since he has exercised all incidents of ownership thereof, including voting said stock and all thereof at all of the meetings of the corporation held since said date.

(b) Dividends were declared on said 1000 shares of stock while held by the depositary and placed in trust for petitioner's benefit.

(c) The corporation at all times considered and treated petitioner as the owner of said stock after its issuance on June 9, 1919 in all corporate affairs.

(d) The consideration for the issuance of said 1000 shares of stock was the execution by petitioner of the distribution agreement of February 5, 1919.

(e) Said 1000 shares of stock were placed with a depositary as security for the performance by petitioner of a distribution agreement entered into between United Artists Corporation and petitioner on February 5, 1919.



(f) The dividends declared on said shares of stock while in the possession of the depository were impounded to encourage compliance by each artist with his distribution contract.

(g) The terms of petitioner's contract, so far as the same related to the number of photoplays required to be delivered and the time of delivery, were abandoned both by United Artists Corporation and by petitioner.

### Argument.

The Tax Court's decision presents a reviewable question. The power of this court to review and dispose of decisions of the Tax Court is derived under I. R. C., Section 1141. Subdivision (c) (1) of said section provides:

*"To Affirm, Modify or Reverse.*—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require."

The key to the Tax Court's decision is set forth in its opinion wherein it is stated:

"The terms and conditions of the agreements briefly referred to above and the action of the parties under them indicate, in our judgment, it was the intention of the parties that ownership of the stock should not pass to petitioner until and unless he 'fulfilled' the terms and conditions of his contract and delivered to the corporation the photoplays stipulated therein. [R. 38.]

"In either event, we are of the opinion that the amount (\$44,532.22 in dividends) was 'received as



dividends from a domestic corporation, which is subject to taxation' under Title I of the Revenue Act of 1934 and hence the credit for normal tax as specified in Section 25 (a) of such Act should be allowed." [R. 44.]

Thus there is presented a conclusion of law or at least a determination of a mixed question of law and fact. Whether such holding of the Tax Court be viewed as a conclusion of law or as a determination of a mixed question of law and fact is immaterial since in either event it is subject to judicial review wherein this court may substitute its judgment for that of the Tax Court.

*Helvering v. Tex. Penn Oil Co.*, 300 U. S. 481, 491;

*Bogardus v. Commissioner*, 302 U. S. 34, 39;

*Union Trust Co. of Butler v. Commissioner*, 84 Fed. (2d) 386;

*Commissioner v. Southern Bell T. & T. Co.* (C. C. A. 6), 102 Fed. (2d) 397;

*Commissioner v. Boeing* (C. C. A. 9), 106 Fed. (2d) 305, 308, cert. den. 308 U. S. 619;

*Hawke v. Commissioner* (C. C. A. 9), 109 Fed. (2d) 946, 950;

*Bynum v. Commissioner* (C. C. A. 5), 113 Fed. (2d) 1, 2;

*A. R. Jones Oil, etc. Co. v. Commissioner*, (C. C. A. 10), 114 Fed. (2d) 642.

A similar result obtains where the Tax Court's determination involves a disregard of evidence having a substantial tendency to prove a different result.

*Farish v. Commissioner* (C. C. A. 5), 103 Fed. (2d) 63, 64-65.

(a) Said Stock Was Issued to Petitioner June 9, 1919, and Ever Since He Has Exercised All Incidents of Ownership Thereof, Including Voting Said Stock and All Thereof at All of the Meetings of the Corporation Held Since Said Date.

In connection with the rights exercised by petitioner as a stockholder while said 1000 shares of stock were held by the depository, Mr. O'Brien testified [R. 220-1] that petitioner exercised all the rights set forth in the by-laws as the holder or owner of the stock; that petitioner voted said stock at all times while it remained in escrow; that petitioner participated fully in the direction of the affairs of the corporation at all times as a stockholder and was very valuable to the corporation; that at all times petitioner's stock was treated exactly as Mr. McAdoo's stock (which was never held by the depository); every stockholder had equal voting rights and equal rights in every respect in connection with their shares of common stock regardless of whether it was in or out of escrow; petitioner had the right to vote and the right to receive notices, and the right to have dividends voted on the stock. [R. 220-1.]

Petitioner from time to time as the owner of said 1000 shares of common stock executed proxies [Exhibits 21, R. 239; 24, R. 245; 25, R. 246, and 28, R. 249] and waivers of notice of meetings. [Exhibits 27, R. 248, and 29, R. 250.]

Petitioner in voting said stock and exercising all the incidents of ownership thereof, was exercising rights conferred upon him as a stockholder of the corporation. Dividends were declared though it is true that pursuant

to an independent contract between the corporation and petitioner and as security for the performance of his obligations under the distribution agreement the actual delivery of the moneys received from dividends to petitioner was deferred. The original preorganization agreement [Exhibit 1, R. 73] on page 4, provides in part as follows:

“The owner of said common stock shall be entitled to one vote for each share of stock owned by him or her.”

Under Article II, Section 1 of the By-Laws of United Artists Corporation [Exhibit 3, R. 93] it is provided in part as follows:

“Certificates evidencing the ownership of the preferred and common shares of the corporation of such tenor and design as the Board may from time to time adopt shall be issued to those entitled to them.”

All of the certificates of common stock under consideration in this case were issued to petitioner on June 9, 1919, and in compliance with the provisions of the by-laws, petitioner owned said shares and must be considered as the person entitled to them. Obviously, under the law stock cannot be issued without creating the relation of stockholder, assuming of course that there was consideration.

The so-called depositary agreement of August 5, 1919 [Exhibit 7, R. 143], in paragraph fifth provides:

“The depositary shall not have the right to vote the shares of stock deposited hereunder.”

and the certificate of deposit [Exhibit 12, R. 195] which was issued to petitioner upon the delivery of said 1000 shares of stock to the depositary pursuant to the agree-

ment of February 5, 1919 [Exhibit 5, R. 114] provides [R. 195]:

“The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation.”

In the case of *Semar v. Commissioner*, 27 B. T. A. 989, in connection with the interest of the petitioner in a contract entered into in the state of Washington, a community property state, prior to petitioner's marriage, the Tax Court stated:

“He was to be given its fruits; the right to enjoy the fruits being, of course, one of the most important incidents of ownership.”

The right to “enjoy the fruits” which petitioner was entitled to exercise in this case was that of voting the stock and exercising all other rights of a stockholder in directing the affairs of the corporation. The Tax Court again in the case of *Semar v. Commissioner, supra*, stated:

“We think as we have said that the petitioner here had an inchoate right to the stock in question before his marriage which does not because of subsequent acquisition of legal title and receipt of the stock certificates thereafter any the less constitute property owned before the marital community began.”

By the same token, the release of the stock by the depository to the petitioner in this case did not any the less constitute a change of ownership because petitioner became the owner of said 1000 shares of stock upon its issuance to him on June 9, 1919.

A case directly in point is that of *Snyder v. Duffy*, 43 Fed. (2d) 642, where the petitioner, a vice-president of a cigar company, entered into an agreement to remain with the company for a period of five years at a stipulated salary. In addition to the salary, he was entitled to receive 1500 shares of the company's stock at the rate of 300 shares each year during the five-year period. The taxpayer received dividend checks regularly upon the basis of 1500 shares of stock during the five-year period, and signed proxies for all meetings of stockholders. The Commissioner treated the receipt of certificates for 300 shares of stock in each respective year as equivalent to the receipt of income for that year to the extent of the value of the stock at the time of the receipt of the certificates. The contract was given the taxpayer in that case by the cigar company to persuade him not to leave the company and enter into a competing business. The question involved is whether or not the beneficial interest in the 1500 shares of stock vested in taxpayer at the time the contract was executed. In reference to the delivery of the stock, the court says:

"It cannot be maintained that actual physical possession is a necessary incident to the vesting of property. The general principle is quite to the contrary and holds that an interest in the property is vested when there is a present fixed right to the enjoyment of income from or increment of the property."

\* \* \* \* \*

"It would appear therefore that when the actual ownership of the 1500 shares of stock was transferred to Mr. Snyder on March 1, 1916, he became the owner of all of said stock at that time despite the fact that the certificates 'mere evidence of the holder's owner-

ship of the stock and all his rights as a stockholder to the extent specified therein' were not delivered into his possession."

The court in the above case distinguished the features of the contract, and declared that the 1500 shares of stock was given taxpayer as an inducement not to leave the company and enter into a competing business, and therefore a beneficial interest vested in taxpayer in 1916 when the contract was entered into, and therefore the value of the 300 shares of stock received each year by taxpayer did not constitute income to taxpayer in the years in which received. The court further stated:

"That the contract transferred all of the rights of ownership in the 1500 shares of stock to Snyder subject only to the provisions of the contract which in reality constituted nothing more or less than a bond for faithful performance. . . . In the meantime it is true he had no right to sell the undelivered portions of the stock, but he had all the beneficial rights therein, and that is more than either the American Cigar Company, or the Seidenberg Co. had. All that Mr. Snyder had to do to acquire complete domination in the situation was to stay alive and to do what he had promised."

The court held:

"The subsequent installment deliveries of stock made from year to year being nothing more than an evidence of ownership already vested in no wise constituted taxable income for such years as saw their physical delivery to plaintiff."

In the present case, the beneficial interest in the 1000 shares of stock vested immediately in petitioner upon its



issuance, and the stock was held by the depositary as a bond for the faithful performance by petitioner of the terms of his distribution agreement [Exhibit 5. R. 114], to wit: the delivery of motion pictures to United Artists Corporation, just as the 1500 shares of stock in the *Snyder* case, *supra*, were held as a bond for Snyder's agreement not to enter into a competing business.

"It is established law that a stockholder is one who holds membership in a corporation by virtue of owning and holding one or more shares of its stock, . . . one who appears on the books of the corporation as the owner of shares and therefore entitled to a voice in the management and burdened with the liabilities incident to that relation . . . whether, as between the corporation and themselves, individuals stand in the relation of stockholders depends, as in other cases involving a contractual relationship, on the intention of the parties as manifested by a correct construction of the agreement in which they have entered . . . ."

*Corpus Juris Secundum*, Volume 18, Section 475,  
Subparagraph A.

Measured by either of the foregoing general rules, there can be no question but what petitioner has been a stockholder of United Artists Corporation since June of 1919.

Measured by the laws of Delaware, the state in which United Artists Corporation was organized in which the foregoing rules of law are applicable, he must be held the owner of said stock for there even one who had subscribed for stock and the stock never even issued has been held a stockholder.

*Hegarty v. American Com. Power Corp.*, Delaware  
Chancery Reports, Vol. XX, page 231.



(b) Dividends Were Declared on Said 1000 Shares of Stock While Held by the Depositary and Placed in Trust for Petitioner's Benefit.

Section 5 of Article II of the By-laws of said corporation [Exhibit 3, R. 93] provides in part as follows:

"Dividends on the preferred and common shares, if declared, severally and respectively shall be payable . . . to the stockholders of record."

In view of the express language in the by-laws, the petitioner as the stockholder of record is the only person entitled to receive the dividends pursuant to the by-laws of said corporation, and the fact that said dividends are placed in trust for the benefit of petitioner as security for the performance of petitioner's obligation is not inconsistent with the established fact that petitioner was the registered stockholder of said stock; otherwise no dividends could have been declared upon said shares of stock. It is obvious and the fundamental law that a corporation cannot declare dividends upon its own shares of stock which the corporation owns since the stock does not constitute an obligation of the corporation until issued or reissued. (*Borg v. International Silver Co.*, 11 Fed. (2d) 147.)

Since the corporation did not own petitioner's stock while the same was held in escrow (otherwise no dividends could be declared thereon) it follows that ownership of this stock was vested in some one else. There is no evidence to indicate that the escrowholder or any one other than petitioner did own the stock. Although petitioner was not entitled to these dividends as and when paid, they

nevertheless did constitute his property and as such constituted taxable dividend income to him in the year paid. The fact that they were held in escrow pending the performance by petitioner of the terms of his picture contract and as security for the same would not release him from the obligation to pay taxes thereon in the year in which they were paid. Therefore these dividends, if taxable at all to petitioner, would have been taxable to him in the years when they were declared and paid and not in the year in which they were released to petitioner from escrow.

In the case of *William R. Hopkins v. Commissioner*, 41 B. T. A., decided May 29, 1940, petitioner agreed to purchase 570 shares of stock of the Buckeye Engine Company. The stock was placed in escrow with the trust company, and the petitioner had the right to withdraw any portion of the stock from the trust company at any time upon payment of the purchase price plus six per cent interest. All dividends were to be applied toward the payment of the stock. By 1926, the dividends on the stock had equalled the purchase price, and in 1930 petitioner made demand upon the trust company for possession of the stock. It refused to deliver possession of the stock to petitioner, and an action was instituted for recovery thereof. A decree was entered in petitioner's favor. The case was decided on appeal in 1933, and the Commissioner contended that taxpayer received this amount of income in 1933. The court in its opinion states:

"If petitioner owned this stock from 1920 and the dividends were paid for his account when they ac-

crued, there being no sale or exchange, the dividends were not income in 1933 when in their then present form they were accounted for pursuant to the court decree. Possession of the securities was retained as security against moneys advanced. Since the petitioner was at all times the owner of the stock, we pass to the question of the dividends. Physical receipt by the taxpayer is not always necessary in order to sustain an application of the rule. There may be a receipt by an agent which is regarded as receipt by the principal. The distributions from 1921 to 1930 were received by the trust company not as owners nor for the sellers, but for the petitioner as the equitable owner."

The facts in the above case are parallel to a great extent to the facts in this case. The petitioner owned the stock at all times after its issuance in 1919, and the dividends were paid into a trust account with the bank for his benefit. The bank paid interest on these dividends which interest was also turned over to the petitioner at the time the dividends were delivered to him.

Th Tax Court in the cases of *Bassett v. Commissioner*, 33 B. T. A. 182, and *Federal Development Co. v. Commissioner*, 18 B. T. A. 971, laid great stress upon the fact that interest was paid the owners of funds held by the depository for the security of the performance of an obligation, and in those cases the fact that interest was so paid was commented upon by the Tax Court as one of the things that led the Tax Court to conclude where ownership of the funds vested.

(c) The Corporation at All Times Considered and Treated Petitioner as the Owner of Said Stock After Its Issuance on June 9, 1919, in All Corporate Affairs.

Petitioner was at all times treated by United Artists Corporation and recognized by it as the owner of 1000 shares of its common stock from and after its issuance on June 9, 1919. This is illustrated by the fact that petitioner's name appears as the owner of said 1000 shares of stock in each of the alphabetical lists of stockholders published by United Artists Corporation on the following dates:

March 1925 [Exhibit 20, R. 238]  
March 1920 [Exhibit 23, R. 244]  
March 1921 [Exhibit 26, R. 247]  
March 1924 [Exhibit 30, R. 252]  
March 1927 [Exhibit 32, R. 254]  
March 1926 [Exhibit 33, R. 255]  
March 1928 [Exhibit 34, R. 256]  
July 1928 [Exhibit 35, R. 257]  
March 1930 [Exhibit 36, R. 258]  
May 1929 [Exhibit 37, R. 259]  
March 1929 [Exhibit 38, R. 260]  
March 1933 [Exhibit 39, R. 261]  
March 1932 [Exhibit 41, R. 263]

In a consent to the adjournment of the annual meeting of stockholders of July 1, 1935 [Exhibit 43, R. 265], there appears the following language:

"We the undersigned being the owners of all the common stock of United Artists Corporation do hereby

. . .

(signed)

CHARLES CHAPLIN—Owner of 1000 shares."

In the minutes of an adjourned annual meeting of stockholders [Exhibit 44, R. 267] there appears the following:

“There were present the following stockholders . . .  
Charles Chaplin . . .”

and at the end of the minutes, there appears:

“Minutes approved:  
(signed) . . .

CHARLES CHAPLIN—Owner of 1000 shares.”

A similar reference is made to Charles Chaplin as “owner of 1000 shares” of common stock of United Artists Corporation in Exhibits 45, R. 269; 48, R. 273; 49, R. 275; 50, R. 277; 51, R. 279, and 52, R. 281.

Reference is made to Exhibits 49, R. 275 and 50, R. 277, for the purpose of showing that petitioner was treated by United Artists Corporation as the owner of 1000 shares, both prior to September 20, 1935, when the last 334 shares of the stock issued on June 9, 1919, were delivered over to him by the depository, and after said date when he had possession of the certificates of stock evidencing the full 1000 shares.

The stock certificates themselves [Exhibit 4, R. 111] evidencing said 1000 shares issued to the petitioner on June 9, 1919, provided in part as follows:

“This is to certify that Charles Chaplin is the owner of . . . common shares . . . of United Artists Corporation.”

Said shares when reissued to petitioner on October 31, 1928 [Exhibit 9, R. 166], provided in part:

“This is to certify that Charles Chaplin is the owner of . . . common shares of . . . United Artists Corporation.”

The corporation in its stock journal, which it furnished the Corporation Trust Company [Exhibit 13, R. 201] shows 1000 shares of common stock to have been issued to Charles Chaplin on June 9, 1919, and reissued to him on October 31, 1928, which reissuance took place pursuant to an amendment of the agreement of February 5, 1919 [Exhibit 5, R. 114] by the agreement of November 22, 1924. [Exhibit 8, R. 148.] And again, Mr. Dennis F. O'Brien in his affidavit of July 25, 1930 [Exhibit 16, R. 296] made at a time when he was a director and attorney for United Artists Corporation, which affidavit was made in connection with corporate matters in which United Artists Corporation was involved in Great Britain, states in part:

“I am duly authorized to make this affidavit on behalf of each of the companies,”

and on page 3 of said affidavit, paragraphs 9 and 10, stated:

“In 1924 (this date is incorrect and should have been (1919) the American Company issued to Mr. Charles Chaplin, Mr. Douglas Fairbanks, and Mrs. Mary Pickford Fairbanks and Mr. D. W. Griffith, each of them 1000 shares of Common stock of no par value.



“When the American Company was incorporated, the Artists, for themselves and their Producing Corporations, entered into agreements to deliver an agreed number of films over an agreed period of years, and as some security for their fulfilling this obligation, it was arranged that all their shares of Common Stock should be deposited with me to be held by me in escrow and as and when the films from time to time were delivered, I released the shares of Common Stock to them, or as directed by them. The said shares at all material times belonged to and were in the names of the said Stockholders.”

In connection with the agreement of November 22, 1924 [Exhibit 7, R. 143], there appears in an excerpt from the minutes of a special meeting of the board of directors dated August 25, 1932 [Exhibit 40, R. 262] the following language:

“It was stated to the meeting that the financial records of the corporation show that at the time of the execution of the aforesaid agreement dated November 22, 1924, all of the preferred and common stock of the United Artists Corporation then outstanding was owned by Mary Pickford Fairbanks, Douglas Fairbanks, Charles Chaplin, David W. Griffith and D. W. Griffith, Inc., subject to certain then existing escrow agreements pertaining to the common stock.”

Had he not been the owner of said shares of stock, would the corporation in preparing alphabetical lists of



stockholders have listed him as the owner of 1000 shares of common stock? Would the corporation have permitted him to sign minutes as "owner of 1000 shares", or would a director and the general counsel of the corporation for and on its behalf have made an affidavit in which he stated that petitioner was on the date thereof and at all times after its issuance the owner of 1000 shares of common stock, or would the corporation in signing a contract, refer to him as the owner of 1000 shares of common stock? There is absolutely no evidence in the record in this case in which petitioner was treated otherwise than as the owner of said 1000 shares of stock at all times, nor is there anything in said record that indicates any question arising as to his ownership of said stock.

Further and most persuasive evidence that petitioner was the owner of said 1000 shares of stock at all times is the reference in the agreement of November 22, 1924 [Exhibit 8, R. 150] wherein it is stated:

"Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all the preferred and common stock of the corporation now issued and outstanding."

Here we have positive and convincing evidence in the form of a contract executed by the corporation's stockholders in which the stockholders all agreed that petitioner is the owner of said 1000 shares of stock. It is worthy of note that said declaration was contained in the agreement executed at least eleven years before this tax controversy arose.

- (d) The Consideration for the Issuance of Said 1000 Shares of Stock Was the Execution by Petitioner of the Distribution Agreement of February 5, 1919.

The consideration for the issuance of 1000 shares of common stock to petitioner [Exhibit 4, R. 111] was the execution by petitioner of the agreement of February 5, 1919. [Exhibit 5, R. 114.] In said agreement it is recited on page 1 that petitioner was well and favorably known to the theatre-going public. That he has been extensively advertised throughout the world wherever motion pictures have appeared, and that the corporation is desirous of inducing petitioner to produce a series of special feature photoplays, and of having petitioner give to it the exclusive right to distribute said photoplays pursuant to the terms of said agreement, and said agreement on page 10 provides:

“And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation nine photoplays.”

The “consideration” referred to above was the agreement upon the part of the corporation to market, distribute, exploit, and cause to be exhibited photoplays produced by petitioner in accordance with the terms and conditions of said agreement.

Mr. Chaplin [R. 323], testified that at the time United Artists Corporation was formed, Miss Mary Pickford was the most important female star in the motion picture business; that Douglas Fairbanks was the first gentleman of

the motion picture industry, and a very important star in the industry, and that D. W. Griffith was recognized as the greatest director at that time. That all four of those individuals, including himself, were constantly in demand by other companies, and received numerous propositions from other companies to produce photoplays for distribution.

Mr. Chaplin also testified that because of the unusual and outstanding abilities and favor with the public of Miss Pickford, Mr. Fairbanks, Mr. Griffith and himself, the execution of the agreement of February 5, 1919 [Exhibit 5, R. 114], and the agreement to subscribe to preferred stock of United Artists Corporation, and the execution of the respective distribution contracts [Exhibit 5, R. 114] was a fair consideration for the issuance of common stock. [R. 324.]

In Exhibit 1, page 1, in making reference to petitioner. Douglas Fairbanks, David W. Griffith, and Mary Pickford, it is stated:

“All of the above named persons are well and favorably known, and their respective names have exceptional trade value in all parts of the world where motion pictures have been exploited and exhibited.”

Mr. O'Brien testified [R. 185] in answer to the question:

“Q. I will ask you why when the corporation was actually organized it was organized under the laws of the State of Delaware? A. Because Mr. Joseph F. Cotton, who was representing Mr. McAdoo desired the corporation to function under the laws of Delaware so to be sure there would be no question as to the proper consideration paid for the issuance of the

stock. He wanted that absolutely clear. He wanted the title to the stock in so far as Mr. McAdoo's 1000 shares were concerned to be without any question. There was some doubt about the laws of the State of New York inquiring into the propriety and accuracy of the consideration."

As shown by Exhibit 14, R. 205, the corporation issued 5000 shares of stock as consideration for the execution by the various individuals of their four distribution contracts. One thousand shares were issued to each of these individuals, and 1000 shares were issued to Mr. McAdoo. There was some question as to whether or not the execution of such contracts would constitute proper consideration for the issuance of said stock under the laws of New York; so instead of incorporating the company as a New York corporation as provided in Exhibit 1, [R. 73] the corporation was incorporated under the laws of the state of Delaware.

Mr. O'Brien, in answer to the question [R. 186]:

"Q. I will ask you what is the consideration for the issuance of those 5000 shares of common stock?"  
said:

"A. It is the consideration that is set forth in the minutes of the first meeting, which I acted as secretary, if I remember correctly, and it was the delivery of the contract not the fulfillment, and the by-laws are all drawn in keeping with that basis and that theory."

And Mr. O'Brien was asked [R. 187]:

"Q. And are those the 1000 shares of stock that were issued to Mr. Chaplin as consideration for the execution of the agreement of February 5, 1919 [Exhibit 5, R. 114]? A. That is my understanding."

As further evidence of the fact that petitioner became the owner of the 1000 shares of common stock upon its issuance on June 9, 1919, there is an entry in the journal of United Artists Corporation in June of 1919 [Exhibit 14, R. 205], as follows:

"June 9 Artists' Contracts A-4	\$25,000.00
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Consideration for contracts with the four artists for delivery of photoplays to Corporation as per resolution of Board of Directors adopted May 29, 1919 (ratified by stockholders Sept. 9, 1919)

Capital stock—Common	C-7	\$25,000.00
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Issued 5000 shares at no par value, but regarded to have a value of \$5.00 per share (verbal advice of General Counsel)."

It is submitted that United Artists Corporation could not have made entries in its books of account similar to the foregoing had it not regarded the execution of the various contracts by the parties who caused it to be organized, including petitioner, to have been proper and sufficient consideration for the issuance of the shares of stock, and if the execution of the contracts furnished the consideration for the issuance of the stock, how could it be contended that petitioner did not become the owner of 334 shares of this stock until 1935 when the actual contract itself [Exhibit 5, R. 114] was executed by petitioner on February 5, 1919?

In the minutes of the special meeting of the Board of Directors held on May 29, 1919 [Exhibit 18, R. 231], the following resolution appears:

“Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, author-

ized to issue and deliver to William G. McAdoo, Esq., one thousand (1000) shares of no par value of this corporation . . .; and

“Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore professionally known as Mary Pickford) one thousand (1000) shares of no par value each, making a total of four thousand (4000) shares. . . .”

The foregoing resolutions themselves show that *the delivery of the contracts to the corporation was the consideration for the issuance of the shares of stock*. This being true, there is no foundation whatever for claiming that the delivery of photoplays was a prerequisite to petitioner becoming the owner of his full 1000 shares of stock.

In Exhibit 55, R. 289, which is a letter from John Fairbanks (brother of Douglas Fairbanks) to Hon. William G. McAdoo, dated March 15, 1919, which is after petitioner had already signed his distribution agreement of February 5, 1919 [Exhibit 5, R. 114], Mr. Fairbanks states:

“Each one of the five stars were to subscribe for one hundred thousand dollars (\$100,000) worth of this preferred stock and they were to get one thousand (1000) shares each of common stock for signing the contract. . . .”



The stock therein referred to was, of course, stock of United Artists Corporation, and the contract therein referred to was the distribution contract. [Exhibit 5, R. 114.] The five stars therein referred to included William S. Hart, who contemplated becoming one of the organizers of United Artists Corporation but subsequently withdrew.

Mr. Chaplin in his testimony [R. 321] in answer to the question:

“Q. Well, do you recall what the consideration was for the issuance of the common stock?”

said:

“A. For the signing, yes, for the signing—make a contract with the company.

Q. The distribution contract? A. Distribution contract.”

In the case of *Ambassador Petroleum Company v. Commissioner*, 28 B. T. A. 868, petitioner agreed to pay \$15,000 in cash and 105,000 shares of its stock for a leasehold interest in certain property in 1920. The stock was not issued until 1923. In 1924, petitioner abandoned the lease and took as a loss in its tax return the sum of \$120,000 representing \$15,000 paid in cash and 105,000 shares of its stock at a value of \$105,000. Petitioner contended that \$105,000 was the reasonable value of said stock in 1920, although it was not issued until 1923. The Tax Court in its opinion stated:

“Where a corporation agrees in 1920 to issue its capital stock in part payment of its property but does not actually issue the stock until 1923, the basic date

for the valuing of the stock to determine the cost of the property is in 1920 when the obligation to issue the stock was incurred.”

Section 3 of the Delaware Corporation Law provides as follows:

“Section 3: No corporation shall issue stock except for money paid, labor done, or personal property or real estate or leases thereof actually acquired by such corporation.”

Reference has heretofore been made in this brief to the fact that the state of incorporation of the corporation was changed from New York to Delaware in order that there might be no question regarding the proper consideration paid for the issuance of the stock. Obviously the only consideration received by the corporation for the issuance of the stock that would come under Section 3 of the Delaware law above quoted would be personal property. That personal property would naturally be the contract of February 5, 1919 [Exhibit 5, R. 114] in which the consideration for the issuance of the stock to petitioner was therein recited. The corporation could not issue the stock to itself since it did not theretofore own the contract. The contract came from the petitioner, and any stock issued in payment of the same would naturally be issued to petitioner. The mere fact that the stock when issued was placed in escrow would not change the ownership thereof. It has become a common custom of placing stock in escrow when issued, particularly in states having so-called “blue sky” laws, where there is some element of promotion involved or where there might be some question as to the value of the consideration received for the issuance of the stock.

(e) Said 1000 Shares of Stock Were Placed With a Depositary as Security for the Performance by Petitioner of a Distribution Agreement Entered Into Between United Artists Corporation and Petitioner on February 5, 1919.

The organizers of United Artists Corporation being persons of long standing in the motion picture business were thoroughly familiar with the requirements of a corporation organized for the sole purpose of distributing motion picture photoplays. They knew that such a corporation would have to be continually supplied with photoplays in order to meet the requirements of its exhibitors, and being able to keep the exhibitors supplied with motion pictures at all times. They were also cognizant of the fact that the motion picture business was a hazardous one, and that there were continual changes in management, reorganization and similar changes, which made it an uncertain business. They fully appreciated the fact that each of the organizers of United Artists Corporation was one of the outstanding—if not the most outstanding—male or female star or director in the industry at that time. Each of these persons was in great demand, and received offers from other companies to distribute their motion pictures. For these reasons at the time the respective artists signed their distribution agreements [Exhibit 5, R. 114] under which they agreed to deliver to the corporation nine motion pictures within a period of three years, they wanted to give each individual all possible incentive to live up to this contract so that dividends would be larger. The safest method they could conceive at the time of guaranteeing each to the other that they would deliver the pictures called for in their contracts was to require their shares of common stock issued to them as consid-

eration for the execution of the contracts to be placed with a depositary along with all dividends that were declared thereon, and for said shares of stock and dividends to be delivered to said individuals on a *pro rata* basis at the time or times they delivered to the corporation pictures for distribution pursuant to the terms of their respective contracts. In this connection, Mr. Chaplin in his testimony [R. 319] testified:

“A. . . . I think, as I say, the question of the 1000 shares of common stock, putting them in escrow, was a part of good-will and an added security for the company in order that we would carry out the terms of our signed contract distributing pictures.”

Mr. O'Brien, an officer and attorney for the corporation who took part in its organization, and has been its general counsel since 1920, with respect to the reasons for escrowing the stock, testified, as follows [R. 213]:

“It was in conformity with the basic agreement in the very last paragraph, as I recollect it, in which they agreed to do certain things with the corporation and for the benefit of each other, and so forth, and that in my opinion that part of that basic contract was never supplemented by any other act done by the parties thereto.

From the very beginning it was the desire—as took place in the discussions and as carried out by the attorneys representing the four participants—that they would own their own corporation. They would have no foreign interest represented in that corporation, and they were going to do as far as they were able, and as far as their attorneys could advise, to put the addition of such a foreign interest—to make

it practically impossible. They had one prohibition in there about the sale of the stock: it would have to be offered to each of the others before it could be sold. Of course, that didn't protect them completely, because the sale price might be way beyond what they would care to pay for it and that foreign interest might come in, just as we had had in another corporation we were in where Miss Pickford had half of the stock, yet that didn't prevent the other half from turning this over to Paramount. The other was that as evidence of their good faith and as their desire to have this whole thing on as near a spirit of equality without one profiting on the stock of the other, so that each one would be entitled to sharing in the number of pictures that was delivered by that person to the others, we all knew, and it was very apparent that these four producers would all start at different times. Mr. Chaplin had quite a burden ahead of him before he would complete his contract, and as it was, it wasn't completed within the three year period. Douglas was nearly ready, and he would start first. And D. W. Griffith came along then, and then Mary had either one or two pictures to finish with First National. Now, then, by putting that stock and the dividends and security for their particular promises to each other and to this corporation, it made it nearly prohibitive for anybody getting into that corporation other than a producer and a producer of the type of motion pictures that would sell themselves and not be sold by other pictures. And that worked out pretty nearly in keeping with what it was originally planned, to make it cooperative. In other words, Douglas had seven pictures delivered. His stock and security and the dividends, if any, coming up. Now, then, Charley would have to deliver an equivalent amount of pictures, or as subsequently

worked out, pictures that grossed equal to the amount of Douglas before he really got the earnings.

It was an equal basis. There was never any thought but what that was the stock of the owners. Otherwise the corporation couldn't function. It would violate every provision of its by-laws and of its incorporation papers. They had the right to vote it and did vote it. It is my belief that when those dividends were declared they then belonged to the owners and the tax then should be paid on them."

In paragraph third, page 6, of the original preorganization agreement [Exhibit 1, R. 73] it is provided:

"Each of the parties hereto agrees with each other and with all the others and with said corporation and for the benefit of all the parties hereto to execute and deliver a contract with said corporation for the sole and exclusive license to market, exploit, distribute, and turn to account the motion pictures that each shall produce. . . ."

The foregoing seems to be a basis for the deposit of stock of each producing owner as security for the "benefit of said corporation and for the benefit of all the parties hereto"; the benefit of the corporation being the security for the performance by the producing owners, and for the benefit of each other to the extent of providing sufficient high-class motion picture photoplays to enable the corporation to function effectively.

The balance sheet of the corporation of October 1919, seven months after the organization of the corporation



contained an item "Artists contracts \$25,000.00" under assets, and under liabilities "Capital stock common \$25,000.00."

In the case of *Federal Development Co. v. Commissioner*, 18 B. T. A. 971, petitioner in March of 1919 entered into an agreement for the sale of certain real property for \$963,500. The property at the time was occupied by Fairbanks Co. as lessee. The purchaser withheld the sum of \$50,000 as a guaranty against his failure to obtain possession of the premises on March 1. 1920. The purchaser agreed to pay interest on the sum of \$50,000 during the time it retained the same. Petitioner contended that the \$50,000 was not received by it in 1919 and it was not possible to determine what portion thereof it would receive until the following year. The court held that the act of the purchaser in paying over the entire amount of the purchase price and then receiving back a deposit of \$50,000 makes no difference. The sum was held from time to time as money belonging to the petitioner, interest being paid the latter for the time it was held. The court in its opinion stated:

"The fact that one who sells property guarantees the purchaser against some contingency arising in a future year and makes a deposit as security for the guarantee does not lessen by the amount of the guarantee or the amount of the deposit the profit which he had made on the sale."

In the present case, petitioner received interest on the dividends while they were held in trust for petitioner,

and as stated in the above case it was immaterial that the stock and dividends did not come into petitioner's hands and then be placed with the depository. The stock and dividends were held and remained as a security for the performance of petitioner's obligation, to-wit: the delivery of motion pictures, and the fact that they were so held does not lessen or dispute the fact that petitioner became the owner of his stock when the same was issued on June 9, 1919.

Another case directly in point is that of *H. L. Carhahan v. Commissioner*, 21 B. T. A. 893. In that case the Union Mortgage Co. was organized in 1921 and 1922 received a permit from the Commissioner of Corporations of the state of California to sell 100,000 shares of its common stock at \$12.50 per unit. In 1922, petitioner, an attorney, was engaged to render legal services to the corporation for which he was to receive 10,000 shares of said common stock. The services were rendered by the attorney in 1922, and in that year he received an interim trust certificate for the stock. The stock was later transferred to him in December of 1922, but was then deposited by him with a depository approved by the Commissioner of Corporations to be held in escrow until further order of the Commissioner. In 1924, the escrow was terminated, and the stock was delivered to said attorney. Dividends were paid to the attorney on the stock held in escrow in October of 1923, and he voted the stock at all times. The question presented was whether or not the stock constituted income to him in 1922, the year in which his ser-

vices were rendered and the stock issued, or 1924, when it was released from escrow and delivered to petitioner. The Tax Court in its opinion emphasized the fact that during the time the stock was held in escrow, the attorney voted the stock and received the dividends thereon. Furthermore, he received the certificate for the stock which was issued in his own name and deposited it in escrow in accordance with the requirements of the state law. The Tax Court stated that he received all the benefits possible from the stock in question except the right of actual physical possession and unrestricted power of sale thereof, and, therefore, the stock constituted income to him in 1922 and not in 1924 as contended by the respondent. In the present case, petitioner likewise enjoyed all the incidents of ownership of his stock while in escrow, including voting the stock at all times. It is true that petitioner's dividends were held for him in trust as security for the performance of his obligation to deliver pictures as was the stock. This did not in any way, however, diminish his legal ownership of his stock, or the dividends, but merely delayed the time when he would come into physical possession thereof.

**(f) The Dividends Declared on Said Shares of Stock While in the Possession of the Depositary Were Impounded to Encourage Compliance by Each Artist With His Distribution Contract.**

It is submitted that one of the most important reasons for placing the stock with the depositary in this case was to prevent the various stockholders from receiving dividends on their shares of common stock until such time as they had delivered to the corporation motion pictures. The stock certificates themselves [Exhibit 4, R. 111], as well as the by-laws of the corporation [Exhibit 3, R. 93], contained restrictions upon the transferability of the stock. These restrictions made it impossible to transfer these shares of stock to anyone other than the stockholders of United Artists Corporation. Consequently the corporation could have delivered to petitioner his 1000 shares of stock when issued in 1919 and still have had the same protection had it required the dividends on the stock to have been held in escrow for petitioner until such time as he delivered to the corporation motion pictures. It would have been manifestly unfair for a producer to have received dividends on his shares of stock resulting from the release by said corporation of pictures produced by other artists when he had not delivered to the corporation any pictures of his own. The dividends, therefore, were required to be placed in trust for petitioner, as well as the other stockholders, to encourage the speeding up of production of their pictures.

(g) The Terms of Petitioner's Contract so Far as the Same Related to the Number of Photoplays Required to be Delivered and the Time of Delivery Were Abandoned Both by United Artists Corporation and by Petitioner.

Petitioner's distribution contract [Exhibit 5, R. 114] called for nine pictures to be produced within three years. These pictures were to be from 1600 to 3000 feet in length. Petitioner departed from this type of picture in the very beginning because he thought the subject matter warranted a longer length picture, and he was not as he thought restricted to any particular length of picture. [R. 316.]

Each picture produced by petitioner pursuant to his distribution contract [Exhibit 5, R. 114] was in excess of 5000 feet in length. Having entered upon a program of making motion pictures much longer in length than those contemplated in the distribution agreement, it would have been impossible for petitioner to have made nine pictures within the three-year period called for. As a matter of fact, petitioner by reason of previous commitments and increasing the length of pictures was unable to deliver a single picture to United Artists Corporation within said three year period. There was no extension of his contract or amendment thereof granting petitioner a longer period of time to produce said pictures. Notwithstanding this fact, petitioner's stock was not forfeited or turned back to United Artists Corporation, as was provided in Exhibit 7 [R. 143], nor was any demand made

upon the depositary or petitioner by United Artists Corporation or any stockholder, director or officer thereof for the return of said stock. It is true that on November 22, 1924 there was an agreement entered into [Exhibit 8, R. 148] which provided that petitioner would be obligated to deliver to the corporation five additional motion picture photoplays instead of eight undelivered pictures provided in said distribution agreement of February 5, 1919. [Exhibit 5, R. 114.] On November 22, 1924 petitioner had delivered to the corporation one motion picture pursuant to his distribution agreement. Said agreement of November 22, 1924 [Exhibit 8, R. 148], further provided that all five of said remaining motion pictures should be delivered by petitioner on or before January 1, 1929. Notwithstanding this fact, petitioner only delivered to said corporation two pictures prior to January 1, 1929, namely, *THE GOLD RUSH*, on August 16, 1925, and *THE CIRCUS* on January 7, 1928. There was no extension of this contract; nevertheless, no default was claimed by any one that petitioner had defaulted under his contract, nor was any demand made that the shares of common stock issued to him and held by the depositary at that time should be returned to the corporation. As further evidence of the fact that petitioner and the corporation considered petitioner to be the owner of the 1000 shares of common stock at all times, petitioner would have been entitled to receive a certificate for 167 shares of stock upon the delivery of *THE GOLD RUSH* on August 16, 1925, and a certificate for 166 shares upon the delivery of *THE CIRCUS*



on January 7, 1928. Nevertheless, these two certificates were not delivered to petitioner until November 8, 1928. This is further evidence of the fact that petitioner considered himself the owner of this stock at all times, and he was not worried or even interested in getting the stock out of the possession of the depositary as soon as he delivered each picture. The evidence in this case fully bears out the fact that the corporation and the various artists owning stock in the corporation were only interested in seeing that the corporation received pictures to distribute from time to time. They were not worrying about their shares of common stock. As a matter of fact, not a single one of them produced and delivered to the corporation their full quota of nine pictures within the three-year period called for in their contracts. Petitioner departed entirely from his original plan of producing two-reel or three-reel pictures. That the petitioner was not required to deliver the full nine pictures called for under his distribution agreement or even the six contemplated under the amended agreement of November 22, 1924, in order to become the owner of the 1000 shares of common stock is borne out by the fact that he only produced four motion pictures for United Artists Corporation during the period from February 5, 1919, the date of his contract, to September 20, 1935, the date on which the 334 shares of stock were delivered to petitioner. No agreement was entered into in the meantime reducing the number of pictures the petitioner was required to produce. As a matter of fact, petitioner never delivered to said corporation

a single picture within the period of time required under the agreement of February 5, 1919 or the agreement of November 22, 1924, nor did he deliver any pictures in order to get the 334 shares of stock delivered to him in 1935 as was required under his contracts.

If petitioner was not the owner of the 1000 shares of stock during all of this period of time, he would have had no legal right under the articles and by-laws of the corporation to vote the stock, attend directors' meetings, receive notices, etc., and this is true regardless of the fact that the escrow agreement [Exhibit 7, R. 143] gave petitioner the right to vote his stock. The right to become a shareholder in a corporation is subject to such qualifications and restrictions as may be established by the articles or the by-laws for shareholding. (6a *Cal. Jur.*, 357 and 247.)

As heretofore pointed out, a stockholder is one who appears on the books of the corporation as the owner of certain of its shares of stock, and, therefore, is entitled to a voice in the management and burdened with the responsibilities incident to the relationship. (*Lee v. Reifler & Sons*, 43 Fed. (2d) 364.) Petitioner in this case exercised a full voice in the management of the affairs of the corporation at all times. Had he not been the owner of this stock, all rights which he exercised as the owner thereof while it was held by the depositary would have been prohibited by the by-laws of the corporation. Where a corporation under Section 19, Delaware Corpo-

ration Laws, acquires shares of its own stock, this stock cannot thereafter be voted directly or indirectly so long as it is owned by the corporation.

United Artists Corporation by executing the distribution agreement [Exhibit 5, R. 114] obligated itself to issue said 1000 shares of stock to petitioner. The stock was issued pursuant to this obligation on June 9, 1919. Ever since said date petitioner has voted said stock as a stockholder, has executed proxies, has had his representative act, or he himself has acted, as a director of said corporation. This corporation for sixteen years preceding the year concerning which this controversy arose, kept full and complete records, rendered its reports to the state of Delaware, prepared and filed tax returns, and in every manner carried on a successful, legitimate business, and had its records closely supervised and examined. The action of the respondent in treating this 334 shares of stock as income to petitioner in 1935 is the first and only contention by anyone that petitioner had not owned said stock since 1919.

### Conclusion.

In conclusion, it is submitted that the record in this case shows that petitioner became the owner of the 334 shares of stock in question upon its issuance on June 9, 1919; that the consideration for said stock was the execution by the petitioner and delivery to the corporation of the distributor's contract; that during all of the time the stock was held by the depositary, petitioner exercised all incidents of ownership of said stock, except the physical possession of the certificates themselves and the dividends declared thereon; that the corporation in all corporate affairs, records, contracts, and transactions regarded him at all times as the owner of the stock; and that the stock was placed with a depositary as a guarantee by petitioner of the performance of the terms and conditions of his distributor's agreement, to-wit: the production and delivery of pictures to United Artists Corporation. That although petitioner failed to deliver to United Artists Corporation the requisite pictures called for under his contract, nevertheless no forfeiture of his stock took place, and petitioner realized no income by reason of the release of 334 shares of stock in 1935.

Respectfully submitted,

LOYD WRIGHT,

CHARLES E. MILLIKAN,

HERSCHEL B. GREEN,

*Attorneys for Petitioner*